

planning ¹⁶ that Ameritech's CAM lists as a nonregulated activity. Because of the utilization of ISDN and IN functionalities to provide features to PCS providers, Ameritech chose to classify these costs as part of a shared service.

ASI's justification, though, does not provide a reasonable basis for considering a cost to be shared. Many enhanced services will use network functionalities to provide features. If this criteria were used, regulated operations would cross-subsidize many enhanced services that would never have their costs directly assigned to nonregulated activities. If ASI had directly assigned the costs of PCS Trials to nonregulated activities, the allocation to nonregulated activities would have increased from \$630 to \$630,000 as the shared cost pool for engineering expenses had 0.1 percent allocated to nonregulated activity in 1992.

Out of ASI's approximately 200 work profiles, ASI classified only two as directly assigned to nonregulated cost pools. Premise Services Family and Ameritech Call Detail represent the only two current nonregulated services. As a result, ASI directly assigned only \$0.9 million to nonregulated cost pools out of ASI's total costs of \$849 million. ASI directly assigned none of the work profiles that include development of future products to nonregulated activities.

6. ASI has leased excess space in its new headquarters in which ASI plans to house nonregulated affiliates. ASI consolidated the majority of its operations at Hoffman Estates in 1991. As a result of the consolidation, ASI has more square footage of office space than prior to the consolidation. This excess square footage costs the AOCs' ratepayers approximately \$30 million annually. Moreover, ASI plans to lease this excess space to nonregulated affiliates as they expand their operations.

The auditors reviewed the costs of the consolidation of much of ASI's operation at Hoffman Estates. Their analysis shows that occupancy costs increased by up to \$30 million when ASI moved from 10 locations in the Chicago area to Hoffman Estates. The analysis concludes that the excess square footage that ASI has leased cause this increase.

¹⁶ An enhanced service is a service offered over common carrier transmission facilities used in interstate communications, which employs computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provides the subscriber additional, different, or restructured information; or involves interaction with stored information.

SQUARE FOOTAGE

	1990	1992
Rent and Property Taxes	\$14,800,000	\$22,200,000
Square Feet	553,926	981,000
Occupancy Headcount	1,972	1,779
Cost per Square Foot	\$27	\$23
Square Feet per Person ¹⁷	281	551

¹⁷ In Docket No. 2180-TI-105 concerning GTE North, Inc. the Public Service Commission of Wisconsin ruled that between 250 and 300 square feet of office space per employee was reasonable.

OCCUPANCY COSTS

SMillions----	1991	1992	11 mo. 1993
Rent Expense	\$16.0	\$15.5	\$8.7
Lease Termination Costs ¹⁸	7.6		
Warehouse	1.1	0.9	1.0
Hoffman Estates			
Rent		15.6	15.0
Property Taxes		6.6	7.2
Operating Exp. ¹⁹			6.6
Total Hoffman Estates ²⁰	9.7	22.2	28.8
Building Services	2.5	7.2	2.4
Utilities	2.3	4.8	1.5
Other	22.0	28.6	29.5
Total Occupancy per Financial Statement	\$61.2	\$79.2	\$71.9

¹⁸ The audit team believes that the General Ledger includes this amount in Rent expense in 1991. This appears reasonable in light of the fact that 1990 occupancy, building and utility expenses were \$15.5 million per ASI trial balance.

¹⁹ In 1992, ASI accumulated Hoffman Estates' operating expenses with other locations' Building Services. In 1993, ASI recorded Hoffman Estates' operating expenses in a separate account.

²⁰ Includes \$2.2 million expenses in 1992 that affiliates reimbursed to ASI.

ADJUSTED OCCUPANCY

\$Millions	1991	1992	1993
Total Occupancy Per Financial Statements	\$61.2	\$79.2	\$71.9
Less Double Occupancy Costs	9.7	7.0	
Less Lease Termination Costs ²¹	7.6		
Less Reimbursements		2.2	
Adjusted Occupancy Costs	\$43.9	\$70.0	Annualized based on 11 months actual costs \$78.4

If the 1991 level of occupancy costs had increased each year by the rate of inflation, occupancy costs should have amounted to \$48.5 million in 1993. Because of the increased space and increased operating expenses, though, the 1993 annualized occupancy costs were \$78.4 million. This represents an increase of up to \$30 million in occupancy expenses. This figure includes increased rent, property taxes and building services²² of \$29 million for Hoffman Estates, reduced by other rental location costs of \$7 million, plus an increase in operating expenses by \$8 million²³.

The auditors found ASI's response to how it plans to fill its excess space particularly disturbing. ASI stated that Ameritech will continue to move Ameritech subsidiaries into the building. During the interim, the AOCs' ratepayers will continue paying for the excess space. The auditors believe that these actions violate the FCC's used and useful standard. The used and useful standard denotes property dedicated to the efficient conduct of a utility's business, presently or within a reasonable period. The standard reflects the principles that owners of public utilities must receive an opportunity to be compensated for the use of their property in providing a public service and that ratepayers must not be forced to pay a return on investment that does not benefit them directly.

²¹ If these costs were recorded in 1992, this analysis would show a \$21.6 million increase in occupancy costs.

²² Building services include expenses for janitorial services, guard services, repairs, landscaping and snow removal.

²³ Operating expenses include expenses for copier, telephone, equipment and office supply services.

7. ASI failed to bill Ameritech Publishing, Inc. (API) \$142,838 for services provided under work profile 020003. Under billable work profile 020003, ASI develops computerized billing procedures for new products and services. Due to a billing error, ASI billed the AOCs for costs that ASI should have charged to API for the development of new billing procedures.

During their review of work profile 020003, the auditors noted that the description of this work profile described work performed for Ameritech Publishing. However, when the auditors reviewed the amounts billed for the work profile, they found that ASI had billed no costs to Ameritech Publishing. When the auditors questioned ASI about these costs, ASI stated that an error in billing procedures existed and that, as a result of this audit, the billing procedures had been corrected. ASI also stated that it had billed API \$142,838 for the costs ASI incurred to provide the services to API.

Observation

1. Ameritech's policy of transferring AOC employees to ASI may impact the AOCs' wage allocator in the Ameritech CAM. Ameritech has adopted a policy of transferring AOC employees, who perform functions that Ameritech believes should be provided as a centralized service, to ASI. As a result, costs that were formerly classified as wages and salaries on the AOCs' books fall into the other expenses category. This could change the proportion of the AOCs' wages that are assigned to its regulated and nonregulated operations.

Ameritech reduced its staff by 5,890 employees between 1990 and 1992 and transferred 2,781 employees from the AOCs to ASI in 1992 and 306 employees in 1991. These changes could have a significant impact on the wage allocators prescribed in the Ameritech CAM.

The Ameritech CAM uses an allocator of total operating company wages and salaries to allocate cost in selected cost pools in the following accounts:

1. Account 1439, Deferred Charges
2. Account 4100, Net Current Deferred Operating Income Taxes
3. Account 4120, Other Accrued Liabilities
4. Account 6711, Executive
5. Account 6723, Human Resources
6. Account 6728, Other General and Administrative

The Ameritech CAM also uses an allocator of total company wages and salaries less direct construction, installation and repair wages and salaries to allocate costs in selected cost pools in the following accounts:

1. Account 2122, Furniture
2. Account 2123, Office Equipment
3. Account 2124, General Purpose Computers
4. Account 6726, Procurement
5. Account 6728, Other General and Administrative

The auditors analyzed ARMIS data from Ameritech's 43-03 reports to determine if Ameritech's reduction in its work force and the transfer of employees from the AOCs to ASI may have affected the amount of total costs the AOCs assigned to wages since 1989 and the use of wages as an allocator in the Ameritech CAM. The following chart shows the result of this analysis:

COMPOSITION OF AOC EXPENSES

		(000)		
	1989	1990	1991	1992
Total Expenses	\$6,674	\$6,882	\$7,063	\$7,361
Wages & Salaries	\$2,225	\$2,221	\$2,102	\$2,003
Percent of Total	33.34%	32.27%	29.76%	27.21%
Other Expenses	\$3,761	\$3,960	\$4,256	\$4,566
Percent of Total	56.35%	57.54%	60.26%	62.03%

The auditors believe that the consolidation of employees could mean that the wage allocator in Ameritech's CAM no longer serves as a cost-causative allocator and could impact the allocation of costs between the AOCs' regulated and nonregulated operations.

**AMERITECH'S RESPONSE TO THE
REPORT OF THE JOINT AUDIT TEAM'S
REVIEW OF AFFILIATE TRANSACTIONS
AT
AMERITECH SERVICES, INC.**

MAY 1995

Audit Report
On
Review of Affiliate Transactions
at
Ameritech Services, Inc.

Ameritech Response

Executive Summary

An audit team -- consisting of staff members from the Federal Communications Commission (FCC), the Public Utilities Commission of Ohio (PUCO) and the Public Service Commission of Wisconsin (PSCW) -- issued an audit report entitled, "Review of Affiliate Transactions at Ameritech Services, Inc." The report made seven findings. The first finding claims that Ameritech Services, Inc. (ASI), a subsidiary of the Ameritech Operating Companies (AOCs)¹ failed in many instances to provide sufficient written documentation to allow the audit team to analyze and substantiate, to the audit team's satisfaction, ASI's rationale for apportionment of its costs between regulated and nonregulated AOC services.

In this response, Ameritech will demonstrate that ASI provided more than sufficient information to enable the audit team to determine not only how the apportionment between regulated and nonregulated operations was done, but also whether the apportionment was reasonable. In addition, Ameritech will explain why each and every one of the remaining findings are completely without merit. Given this response, it is apparent that the joint audit, as a whole, should be rejected.

At the outset, Ameritech challenges the findings in the report because two other audits of ASI covering the same 1992 time period did not reach similar conclusions. Specifically, two audits, one conducted by Arthur Andersen and the other by Frederick & Warinner on behalf of the Illinois Commerce Commission, audited ASI's costs accumulation and allocation procedures, and these audits did not find that ASI did not provide sufficient written documentation to justify its cost allocations. Rather, those auditors found ASI's procedures provided sufficient assurance that the AOC's comply with the FCC's Part 32 and Part 64 rules.

¹ The Ameritech Operating Companies provide local telephone services in the Ameritech region under the following names: Ameritech - Illinois, Ameritech - Indiana, Ameritech - Michigan, Ameritech - Ohio, and Ameritech - Wisconsin.

AOCs' regulated and non-regulated services is consistent with the proportion of the AOCs' overall regulated and non-regulated costs and revenues.

Based on the foregoing, Ameritech challenges each and every finding in the report. The FCC, PUCO, and PSCW should reject the report. Furthermore, should the audit team respond to Ameritech's filing with additional facts and arguments not previously provided in the report, Ameritech must be given an opportunity to respond to those new arguments. Denying Ameritech the opportunity to address these new issues would be contrary to the concepts of due process and the "notice and comment" provisions encompassed in the Administrative Procedures Act. 47 C.F.R. §553.

TABLE OF CONTENTS

	<u>Page</u>
I. Introduction	1
A. The Audit Process	1
B. The Audit Findings	2
II. The Audit Report Does Not Support Its Findings	3
A. Other Audits of ASI in 1992 Contradict the Audit Team's Findings	3
B. The Report is not Well-Grounded in Fact.	4
III. Finding 1: ASI Provided All Information Necessary for the Audit Team to Determine the AOC's Ability to Comply with the Commission's Rules.	6
A. Introduction	6
B. Task 1: The Audit Team had More Than Sufficient Information to Track ASI's Costs to Part 32 Accounts and Part 64 Cost Pools.	7
1. ASI's cost accumulation and allocation process are understandable.	7
2. Assigning costs to Part 32 accounts and specific cost pools is not a difficult process	11
3. The audit team had all the information necessary to determine how ASI allocated its costs between regulated and nonregulated operations.	14
C. Task 2: The Audit Team had More Than Sufficient Information to Evaluate Whether ASI's Cost Allocations Were Reasonable.	15
1. The audit team was provided sufficient written documentation	15

2.	The report's characterization of the managers' interviews is inaccurate	16
3.	The audit team had information about the benefits of ASI's services to the AOCs.	17
4.	The audit team did not need written explanations about how ASI classified billable and nonbillable work profiles to evaluate the reasonableness of that classification.	18
5.	The audit team had sufficient written documentation to understand ASI's allocations and Finding 1 is not supportable.	18
IV.	Finding 2: The Costs of the Data Center Consolidation Were Appropriately Allocated Among the AOCs.	21
V.	Finding 3: ASI Properly Assigned the Costs of the Work Profiles Cited in the Report	22
A.	The Costs of Ameritech Directory Search Were Appropriately Assigned.	23
B.	The Costs in Marketing New Applications Were Appropriately Assigned.	24
C.	The Costs of New Product Development Technical Support Were Appropriately Assigned.	24
D.	The Costs of New Products Were Appropriately Assigned.	25
E.	The Costs of Speech Technologies Evaluation Were Appropriately Assigned.	25
F.	The Costs of Video Conferencing Prototype Were Appropriately Assigned.	26
G.	The Costs of Human Factors Were Appropriately Assigned.	27
H.	ASI is Not Biased Against Assigning the Appropriate Level of Costs to Nonregulated Operations.	27

VI.	Finding 4: ASI Appropriately Assigned the Costs of the SMDS Trial.	28
VII.	Finding 5: ASI Recorded the Costs of the PCS Trial to the Correct Part 32 Account and Appropriately Assigned the Costs of the PCS Trial.	29
VIII.	Finding 6: ASI Lease of Space at the Ameritech Center Does Not Violate Any FCC Rule.	31
IX.	Finding 7: Ameritech Publishing, Inc. Should Not Have Been Billed for \$142,000.	34
X.	Portions of the Report are Irrelevant and Should be Removed.	35
A.	The Report's Discussion on ASI's Cost Reduction Measures is Irrelevant.	35
B.	The Report's Discussion on Material Logistics is Irrelevant.	36

Ameritech Response

I. Introduction

A. The Audit Process

In April, 1992, the staff of the FCC initiated an audit of Ameritech Services, Inc. (ASI) which performs centralized work functions for its owner companies, the Ameritech Operating Companies (AOCs), such as procurement and product management of certain services. ASI also performs similar work on a limited basis for nonregulated affiliates of the AOCs and for a specific AOC. ASI's work for these groups is limited by ASI's Charter. Specifically, for 1992, the costs ASI incurred in supporting either a nonregulated affiliate or a single AOC could not exceed 3% in aggregate of ASI's 1992 budgeted amount. Thus, from the outset, ASI is limited in the amount of work it can do on behalf of nonregulated affiliates.¹

Staff members of the PUCO and PSCW joined in the audit in October, 1992. The purpose of the audit was to determine ASI's compliance with the Commission's affiliated transaction and cost allocation procedures. ASI is not a common carrier and therefore not subject to Part 32 and Part 64 rules like the AOCs. However, because ASI bills a substantial amount of its costs to the AOCs, ASI must be able to provide sufficient information to the AOCs so that the AOCs may classify these costs in compliance with the Part 32 and Part 64 rules.

The audit began in April, 1992 and was conducted over a 21 month time period until January, 1994.² During this time, ASI responded to almost 600 data requests containing over 1000 questions from the audit team; scheduled more than 62 personal interviews during 7 on-site visits from the audit team,³ and sent out more than 98 questionnaires to be completed by both ASI and AOC employees chosen by the audit team. In addition, ASI provided more than 20 in depth presentations to the team regarding ASI's organizational structure and internal processes.

At the start of the audit process, the audit team listened to numerous presentations by ASI employees about ASI's overall budgeting, billing and

¹ The audit team knew that ASI had a limited ability to perform work for nonregulated affiliates. FCC data request June 2, 1993, Question 4 (Att. 5).

² A few follow-up questions were still being answered in April and May, 1994, but the majority of the audit was completed by January, 1994.

³ There were 5 visits to the Ameritech Center in Hoffman Estates, IL; 1 visit to Milwaukee, WI; and 1 visit to Cleveland, OH.

accounting procedures. The audit team also received a copy of all 200 of ASI's work profiles (description of ASI's work) approved for 1992. As the audit progressed, the audit team selected about 40 work profile managers to interview. Of those 40 work profile managers, the audit team interviewed about 29 of them, but also interviewed another 33 managers representing the 40 work profiles. The audit team then selected 16 work profiles – 12 that were directly billed and 4 that were billed using indirect allocation – to review in more depth. From those 16 work profiles, the audit team selected approximately 100 ASI or AOC employees to be interviewed or to fill out questionnaires. With each of the ASI employee interviews and questionnaires, the audit team requested and received, in most instances, an example of the employee's work product.

In addition to the employee presentations, interviews, and questionnaires, the audit team gathered information through data requests. In this regard, the audit team asked both general and specific question about ASI's accounting procedures, billing procedures and work profiles. For example, a data request submitted early in the audit process requested "a flow chart that shows the flow of cost from an account or subaccount, whichever is the lowest level of account, to its assignment to a work profile and to a bill submitted to one of the operating companies."⁴

Then as the audit progressed, the audit team asked more detailed questions regarding ASI's work. For example, for Data Center Consolidation, Work Profile No. 090006, the audit team asked about 119 follow up questions that range from such questions as "[w]hat do the acronyms SWITCH and FACS stand for and what do they mean?" to "[why] does the product line code (60561) for bill lines B088 and B089 differ from that provided in response to question 7 of Attachment 2 Core Data Request (60560 for B088 only; B089 is not listed?"⁵)

B. The Audit Findings

The audit team's primary finding is that ASI failed to provide, in many instances, sufficient written documentation to allow the audit team to analyze and substantiate, to the audit team's satisfaction, ASI's rationale for apportionment of its costs between regulated and nonregulated AOC services.⁶ The report then contradicts itself and makes several specific findings that conclude that ASI did not properly apportion its costs between regulated and nonregulated operations. For example, Finding 2 claims that

⁴ FCC data request June 5, 1992, Question 1.

⁵ FCC, PUCO, and PSCW data request September 10, 1993, Question 9(g) and Question 13(c).

⁶ Report at page 21.

ASI improperly billed the AOCs for all overhead costs related to data center consolidation when some of those costs should have been allocated to the AOCs' nonregulated affiliates. Likewise in Finding 3, the audit team concludes that in at least seven work profiles, ASI improperly allocated all the costs to regulated operations when some of the costs should have been allocated to nonregulated operations. In these instances, Ameritech believes the findings do not relate to the sufficiency of information provided by Ameritech but result from mistaken conclusions by the audit team with respect to the apportionment of costs between regulated and nonregulated operations.

II. The Audit Report Does Not Support Its Findings.

Ameritech contests every finding in the audit report. Not only did ASI provide all the necessary documents and information to enable the audit team to understand how ASI allocated its costs between regulated and nonregulated operations, but ASI also provided sufficient information to justify the regulated and nonregulated allocations it made.

But before responding to specific issues raised by each finding, Ameritech provides these general comments applicable to the entire report.

A. Other Audits of ASI in 1992 Contradict the Audit Team's Findings.

Two other audits of ASI contradict the findings in this report. Specifically, these two audits provide evidence that ASI's written documentation was sufficient to analyze and substantiate ASI's cost accumulation and allocation procedures and to determine that ASI's cost allocation procedures adequately ensured AOC compliance with the FCC's Part 32 and Part 64 rules.

The first audit was an independent audit conducted by Arthur Andersen (AA). Because of the Commission's requirement in § 64.904 that the AOCs have an annual independent audit of their cost allocation procedures and affiliated transactions, and because ASI bills the AOCs for a substantial amount of its costs; AA audits annually ASI's procedures for accumulating, summarizing, and billing costs of ASI's services to the AOCs. By auditing ASI's procedures, AA ensures that transactions between ASI and the AOCs comply in all material aspects with the FCC's affiliate transaction rules. The result of the audit was that AA found no material weaknesses in ASI's procedures and that these procedures comply, in all material respects, with the FCC's affiliate transaction rules.⁷ In fact, the audit team had a copy of the AA management letter for the 1992 ASI audit, and the FCC's Accounting

⁷ See Exhibit 1 for AA Internal memo.

and Audits Division was given copies of and reviewed AA's work papers of the 1992 Part 64 audit of the AOCs.⁸

The second audit was performed by Frederick & Warinner Consultants at the direction of the Illinois Commerce Commission's (ICC). This audit of Ameritech - Illinois required Frederick & Warinner to review ASI's accounting procedures.⁹ One aspect of the auditing engagement required the consultant to

determine whether ASI has appropriate and fully supported procedures in place for accumulating and assigning costs, and whether these procedures are well-defined and consistently applied.¹⁰

While the auditors did make certain recommendations for ASI to use more positive time reporting and AOC specific project codes, and to establish a more formal audit schedule for internal audits focusing on affiliate transactions; the audit report makes it clear that the auditors found ASI's cost accumulation and allocation procedures, and ASI's written documentation sufficient to conduct an audit and evaluate the reasonableness of ASI's cost allocation.¹¹

Thus, these two independent audits covering the same time period and auditing the same procedures reached supportable conclusions that directly contradict the findings in this audit report. And, the audit team was at least aware of the AA audit. Consequently, the AA and Frederick and Warinner audits – together with the failure of the audit team to objectively support its alleged findings – demonstrate that the findings in this report cannot be supported. Therefore, the joint audit report in its entirety must be rejected.

B. The Report is not Well-Grounded in Fact.

Under the Generally Accepted Auditing Standards (GAAS), an auditor must assimilate all the information gathered during the audit and arrive at a reasoned judgment regarding the information. In this regard, GAAS requires that auditors gather sufficient evidence upon which to base their findings.

⁸ FCC data request, June 2, 1993, Attachment 5, Question 2. Moreover, the Accounting and Audits Division was so comfortable with AA's thoroughness and competency in the Part 64 audit of the AOCs, that the Division via a telephone conversation with AA did not require AA to provide its workpapers for its independent audit of the AOCs the following year.

⁹ See Exhibit 2 for Frederick & Warinner Audit Report.

¹⁰ Exhibit 2 at 191.

¹¹ See Exhibit 2 at 204-205.

And, when sufficient information has been obtained, an auditor must evaluate that information in an unbiased manner.¹² Furthermore, in evaluating the information, the evidence need only be persuasive, not convincing.

Despite the requirements of GAAS, the report does not provide an objective reasoned analysis supporting its findings, because much of the discussion is incomplete and inaccurate. Moreover, much in the report is irrelevant to an examination of compliance with Part 32 and Part 64 rules. Listed below are examples, which are discussed in detail later in Ameritech's response, in which the report is either inaccurate, incomplete, or irrelevant:

- the discussion regarding the translation tables in Section IV is inaccurate;
- the discussion regarding the seven work profiles allocated to regulated activities in Finding 3 is incomplete;
- the discussion regarding AADS' development costs in Finding 4 is incomplete;
- the discussion regarding the PCS trial costs in Finding 5 is incomplete;
- the discussion regarding ASI's cost reduction measures in Section VI is irrelevant; and
- the discussion regarding the Material Logistics business process in Section V. is irrelevant.

As these examples demonstrate, in many cases the report lacks any balance in its discussion of the facts and information ASI provided during the audit. Specifically, the report leaves out pertinent information which is inconsistent with, or contrary to, the conclusion of the report. Furthermore, in a number of instances, discussions are included in the report which have no bearing on whether ASI's accounting procedures were sufficient to ensure AOC compliance with Part 32 and Part 64 of the FCC's rules. Finally, in many cases the report includes statements that are factually incorrect. These examples are direct evidence that the report fails to articulate a reasoned basis for its findings. And, these examples also raise serious questions about whether the report is an unbiased assessment of the information gathered during the audit.

Nevertheless, should the audit team respond to Ameritech's Response with facts and analysis gathered during the audit, Ameritech must be given an opportunity to respond to that analysis. Specifically, Ameritech must be

¹² See AU § 326.16 and AU § 326.22 of Generally Accepted Auditing Standards (GAAS), Section 326, Evidential Matter, 326.16 and 326.22.

given an opportunity to respond to the audit team's interpretation of the facts supplied in a specific document, such as the work profile or employee questionnaire, or supplied during an interview or presentation. Without giving Ameritech an ability to respond, the audit team will be able to introduce new evidence to support its findings to which Ameritech would have no opportunity to respond. That would clearly be contrary to the concepts of due process and opportunity to comment embodied in the Administrative Procedures Act.

III. Finding 1: ASI Provided Sufficient Written Documentation to Allow the Audit Team to Substantiate ASI's Rationale for Apportionment of Costs Between Regulated and Non-regulated AOC Services.

A. Introduction

Audit Report's Position. The primary finding in the audit report is that ASI failed to provide sufficient written documentation to allow the audit team to analyze and substantiate, to the audit team's satisfaction, ASI's rationale for allocation of costs between regulated and nonregulated AOC services.¹³ What this finding means is that the audit team felt it could not determine in many instances whether that allocation was reasonable. The audit team bases this finding on the following conclusions:

- there were incomplete written documents;¹⁴
- the elimination or transfer of staff prevented the audit team from obtaining necessary information¹⁵; and
- lack of written procedures to describe how ASI separated costs between billable and nonbillable work profiles prevented the audit team from determining whether the separation was reasonable.¹⁶

Ameritech's Response. To meet the objectives stated in the audit report, the audit team had to complete two tasks: first, it had to learn how ASI's accounting procedures worked, by understanding how ASI's costs were accumulated and then classified on the AOCs' books under Part 32 and Part 64; and second, it had to evaluate whether those accounting classifications

¹³ Report at page 21.

¹⁴ Report at page 21-22.

¹⁵ Report at page 21.

¹⁶ Report at page 16 and 22.

and allocations were reasonable. The audit team was able to complete the first task but apparently was unable to complete the second task to the audit team's satisfaction.

In the following pages, Ameritech will demonstrate the substantial amount of supporting information the audit team requested and received. The audit team had more than sufficient information to evaluate and determine the reasonableness of ASI's accounting classifications and cost allocations, for those 16 work profiles it selected.

B. Task 1: The Audit Team had More Than Sufficient Information to Track ASI's Costs to Part 32 Accounts and Part 64 Cost Pools.¹⁷

- 1. ASI's cost accumulation and allocation processes are understandable.**

ASI work efforts are managed through the Affiliated Management Process (AMP).¹⁸ AMP requires that ASI's work efforts and budget be categorized as either business management work activity or project management work activity. Business management work activities reflect infrastructure work such as efforts required to operate the current business, and include items such as product/market/channel management, technical support, accounting operations and legal. Project management work activities cover discrete work efforts with identifiable start and stop dates and focus on changing business needs. Business management work activities represent 80% of ASI's costs while project management represents 20% of the costs.

All of ASI's work efforts for supporting the five AOCs are documented in work profiles, which are used for grouping resources based upon integrated objectives and funding levels, and for apportioning ASI resources among these work efforts. Of the 1992 budgeted dollars, over 90% of ASI's budget represented work that was a continuation of efforts from 1991. These work profiles, along with other business case analyses for certain strategic initiative work efforts, are provided to ASI's Managing Board (whose voting members

¹⁷ This information was presented to the audit team in the following forums: Overview of ASI Billing process "Billing by Work Profile" handout and presentation by B. Manning, July 14, 1992; Work Profile Process, Billing Systems, Budget/ Cost Assignment/ Accounting Process, presentations by T. Dominak, B. Briggs, M. Laurance, on January 25, 26, and 27, 1993 including handouts; Resource Allocation/Budget Process presentation by M. Laurance on July 14, 1992; Bill Lines/Cost Pools/Accounting/PLC-FRC, Non-reg Billing presentation by B. Briggs, on December 13 & 14, 1993; and ASI Procedures to Assign Costs to Lines, Reg/Nonreg/Shared designations, presentations by T. Dominak, R. Friedberg, B. Briggs, on April 19, 1993.

¹⁸ Presentation on AMP by J. Lenahan in July, 1992 with handout, and the audit team received a copy of the AMP process June 5, 1992.

are the 5 AOC presidents) for approval. Every year work profiles must be updated and approved.¹⁹

In addition, ASI is only allowed to perform a certain amount of work for its nonowner companies. This limitation is imposed during the budgeting and AMP process through the approval of ASI's budget. Specifically, when the Managing Board voted to approve ASI's budget for 1992, it also voted to limit the aggregate amount of work ASI could perform for nonregulated affiliates or a single AOC to 3% of ASI's budget. This limitation avoids ASI spending significant resources to support either a nonregulated affiliate or a single AOC. And, the audit team was aware of ASI's limitation.²⁰

ASI's costs are accumulated into work profiles (and bill lines) for billing the AOCs. Specific work efforts within a profile are subdivided into bill lines (for the accumulation of charges) which are again subdivided into project codes. The project codes map into a bill line. Each work profile can consist of multiple bill lines, but the same bill line number cannot be used for multiple work profiles. For example, a single work profile may be separated into 10 or 12 bill lines, and the different bill lines may be separated into several unique project codes. At the same time the work profile is subdivided into bill lines and project codes, the accounting classification person also assigns a functional accounting code for each bill line and a product line code for each bill line. The functional accounting code and product line code assignments are translated into the Part 32 account and Part 64 cost pool on the books of the AOCs.

All ASI's expenses are first accumulated by responsibility code (RC) (each employee is assigned their own responsibility code) and summed to project code, bill line and work profile numbers. The Cost Allocation Tracking System (CATS) is an ASI accounting system which tracks ASI costs by project code, bill line and work profile. The CATS 1170 report, provided to the AOCs, is a monthly billing summary showing ASI costs: per AOC/ per work profile/ per bill line. It also includes the functional accounting code assignment for each bill line and the product line code for the bill line.

Once the AOC receives the CATS monthly billing report 1170 from ASI, the AOC accounting system translates the functional accounting codes of the different bill lines and books those costs to a Part 32 account. Similarly, the product line codes are translated and the costs allocated to the Part 64 cost

¹⁹ Provided in response to data request on June 5, 1992, Question 2b "Resource Allocation Process," and handout in July, 1992 during on-site visit.

²⁰ See supra note 1.

pool. Again, the audit team understood this process as evidenced by some of the questions in the data requests.²¹

Below is a more detailed discussion of the documents used to accumulate and allocate ASI costs.

a. Work Profiles

The work profiles are used for allocating resources while integrating objectives and funding levels. A work profile form is used to document resource allocation decisions, affiliate interest requirements, and objective setting; it also provides a means for tracking. Included on the work profile document are customer identification, key assumptions, benefits, resource requirements, description of work, prerequisites, and deliverables objectives. In some instances, both capital and expense dollars are also included.

However, these work profile forms are not automatically understandable to persons unfamiliar with the work encompassed in the work profile. Work profiles are internal documents designed to explain the work performed under the responsibility of the profile manager. For example, work profiles often contain numerous company specific acronyms for products or computer programs and references to other company specific work efforts. Thus, persons unfamiliar with acronyms and other references would need further explanations to comprehend what the form includes, as the audit team did in several data requests.²²

Work profiles are also separated into indirect and direct work profiles, or sometimes referred to as nonbillable and billable work profiles. The direct work profiles are billed directly to the AOCs based on the allocation factor, while indirect work profiles are considered overhead expenses and allocated

²¹ April 9, 1993 data request Questions 1-4; April 20, 1993 data request Question 3; June 6, 1993, Att. 2, Questions 7-9; September 10, 1993 data request Question 7 follow-up, a and b; November 10, 1993 data request Joe Buckley follow-up, Questions 7, 8, 11, 12; November 18, 1993, Nov. 10, 7A, a follow-up, K. Klingbeil, Questions 2-5.

²² January 27, 1993 data request Questions 2, 3, 5, 11, and 14; September 10, 1993 data request Question 13 (c) and (d), and Economic Evaluation (b); September 10, 1993, G. Smith Questionnaire, Questions 8, 9, and 11; September 10, 1993, C. Kane Questionnaire, Question 6; and September 10, 1993, data request entitled Other Requests, (b); and September 10, 1993, Internal Audits, (a).

over the direct work profiles. The audit team was given a complete list of all work profiles, which identified whether the work profile was directly or indirectly billed to the AOCs. In addition, the audit team reviewed all the nonbillable work profiles.²³

b. Bill Line/Project Code

As noted above, specific work efforts within a work profile are subdivided into bill lines and project codes. Bill lines provide the "lowest common denominator" of billing information regarding work profiles. Each bill line can have only one functional accounting code under which the work is being performed. Because the function codes are the bases for assigning Part 32 account classification numbers, expenses associated with each bill line cannot be split into more than one Part 32 account.²⁴

The bill line is a six character sequence, including both numbers and letters. Some of the characters represent specific information, while other characters do not. In this regard, the first character provides information identifying the jurisdiction for which the work is being performed. For example, bill lines beginning with the letter A are billed to all AOCs. Likewise, bill lines beginning with the letter M are billed solely to Ameritech - Michigan. The letters H, L, N and W represent individual billings to Ameritech - Ohio, Ameritech - Illinois, Ameritech - Indiana, and Ameritech - Wisconsin, respectively.

The next three characters, i.e., characters 2 through 4, of the bill line are assigned in sequence but do not contain any accounting information. There were some instances in which the accounting classifications person would try to include letters or numbers from the work profile number in those places to make the bill line number appear more logical, but that was not done consistently. The fifth character in a bill line identifies the cost pool to which the costs are being allocated. In this regard, the R identifies a regulated cost pool, an S identifies a shared cost pool, and an N identifies a nonregulated cost pool. The sixth character in a bill line is either a 0, or in the case of category II employees a 2. The only exception to this identification process is the Information Technology (IT) bill lines; these bill lines all end in 00. Because all IT bill lines end in 00, one cannot determine from the bill line what cost pool the costs are being allocated to. But, that information can be

²³ See FCC data request December 3, 1992, Question 1 "the list of nonbillable work profiles contained data separated into columns with the following headings...." And, see Questions 2 through 5 which ask specific questions about the nonbillable work profiles.

²⁴ There are some limited instances in which a bill line may be allocated to more than one Part 32 account. Bill lines also may be divided between more than one cost pool, but cost pool assignment is usually done on a product line code basis.

determined by translating the product line codes assigned to the bill line into a Part 64 cost pool, with the PLC translation table, which was provided to the audit team.

While bill lines are used for cost allocation purposes, bill lines and project codes are used for internal tracking purposes. For example, the manager of a group of computer programmers may have two project codes established to differentiate the costs of maintaining a software program from the costs of improving the program. While adding to the complexity of the accounting system, these additional project codes do not impact the Part 32 and Part 64 classifications and therefore do not need independent support or justification for the cost allocation.

2. Assigning costs to Part 32 accounts and specific cost pools is not a difficult process.

The accounting classification person works closely with the work profile manager and budget advocate to classify the costs of the work profile. In order to ensure that the assignment of ASI's costs are consistent with the Commission's cost allocation and affiliate transaction rules, the accounting classification person has substantial knowledge about the FCC Part 32 accounts and Part 64 cost pools. Thus, the accounting classification employee assigns a function code and product line code to a bill line based on the work profile, discussions with the work profile manager, the organization budget advocate, and substantial knowledge about the Commission's accounting and cost allocation rules.²⁵

In addition, the accounting classification expert follows the hierarchy approach prescribed by the Commission when determining product line code, *i.e.*, cost pool assignments.²⁶ Specifically, the first step of this approach is to determine if the costs of the regulated activity can be directly assigned, *i.e.*, whether the activity exclusively supports either a regulated or nonregulated operation. If the costs cannot be directly assigned, the next step is to determine whether there is a method to directly attribute the costs to either regulated or nonregulated accounts, *i.e.*, whether there is a direct analysis of

²⁵ An AS311 form was generally used to get a new bill line or project code entered into ASI's accounting system. On that form, the accounting classification person would enter the new bill lines and project codes, and would list the functional accounting codes and product line codes that were assigned to the new bill lines. Although ASI could not produce all the AS311s requested by the audit team, the AS311 form was not necessary to determine how or why cost assignments or allocations were made. Specifically, the AS311 is strictly an administrative form, and in most cases, did not include a written explanation underlying the functional accounting codes or cost pool assignments.

²⁶ 47 C.F.R. § 64.901(b).

the costs themselves on which to allocate costs. If the costs cannot be directly attributable, the accounting classification expert must determine if they can be indirectly attributed, i.e., whether there is an indirect, cost causative linkage to another cost category for which direct assignment or allocation is available. Finally, if the costs cannot be allocated using any of these methods, the cost may be assigned using a general allocator.

In any event, there are a limited number of Part 32 accounts and Part 64 cost pools in which to classify ASI's costs. The accounting classification person has a limited number of Part 32 accounts because ASI's use of revenue and other income accounts is very limited. For example, if the costs are marketing expenses, then the accounting classification employee has only one account to assign the costs to: Account 6611, Product Management. If the costs are sales expenses, the accounting classification employee again has one account: Account 6612, Sales. And, finally, if the costs are advertising expenses, the accounting classification employee has one account: Account 6613, Product Advertising.

Similarly, for computer expenses, the accounting classification person has only two Part 32 accounts in which to charge those expenses, specifically Account 6724, Information Management and Account 6124, General Purpose Computer Expense. And, pursuant to a data request, ASI completely explained to the audit team how it classified computer expenses.²⁷ As further evidence of the limited choices for Part 32 accounts, there were only 7 Part 32 expense accounts to which costs were charged for the 12 directly billed work profiles the audit team selected for review.

The assignment of a Part 64 cost pool by the accounting classification employee is likewise limited. In this regard, once costs are assigned to a Part 32 account there is a limited number of cost pools under that Part 32 account to which the costs may be allocated. All of these cost pools are listed in the AOCs' Cost Allocation Manual (ACAM), which is filed with the FCC and updated on a quarterly basis. For example, Account 6124 has only three cost pools to which ASI can allocate costs: a regulated cost pool, whose costs are directly assigned; a nonregulated cost pool whose costs are directly assigned; and a shared cost pool whose costs are indirectly assigned based on the relative cost of the investment in Account 2124. Attached as Exhibit 3 is a list of all the Part 32 accounts and corresponding Part 64 cost pools available for the 12 direct billed work profiles reviewed in-depth by the audit team.

The Part 32 and Part 64 classifications are not difficult to determine if the individual has sufficient experience with the Part 32 and Part 64 rules, and

²⁷ See data request and flow chart in April 20, 1993 data request Question 3.

access to information regarding the work encompassed by the work profile.²⁸ Exhibit 4 provides a description and analysis for classifying the Ameritech Integrated Marketing System (AIMS). This example demonstrates that the classification of work profiles is a logical progression: understand the work being performed, classify the work under a function code and Part 32 account, and then classify the work in the Part 64 cost pool according to available cost pools. Based on the foregoing paragraphs, the classification and assignment of costs is a simple process, and one which the audit team fails to explain why it could not follow.

The report also makes an inaccurate claim that ASI's Accounting Standards group used incomplete translation tables for translating ASI's bill lines and function codes into Part 32 accounts and Part 64 cost pools. The audit team then claims it could not review the necessary source documents to examine the classifications.²⁹ Moreover, the report states that ASI omitted certain bill lines from the translation tables provided to the audit report.

Not only is that statement completely false, but ASI has already told the audit team in informal comments that it was factually incorrect. Specifically, pursuant to a March 3, 1993, data request, ASI provided to the audit team an official copy of a Wisconsin PLC-EXTC translation table. Pursuant to a November 18, 1993 data request, ASI provided a translation table showing the Part 64 cost pool for each ASI project and service billing product line code.³⁰ There was nothing incomplete about this table. Furthermore, the audit team was offered – but refused – a copy of the 5 binder official translation table that showed the Part 32 account that each function code was booked to.³¹ Instead, the audit team chose to rely on an unofficial translation table that an employee had put together for personal use. While that unofficial translation table did not contain all bill lines, ASI did not omit any of this information from the translation table. Moreover, the audit team was told on numerous occasions that the unofficial translation table was incomplete and not an

²⁸ In this regard, the audit team asked for an explanation as how the classifications were made. See FCC data request January 27, 1993, Question 5 "[w]ork profile 140007 Acct Standards - Provide any manual or standards that describe how costs are assigned to regulated or nonregulated or shared services." See also data request FCC June 2, 1993, Questions 7 through 9, Att. 2. See also Ohio data request May 18, 1993, Question 14 "what instructions does OBT get from ASI regarding how to book ASI costs?"

²⁹ Report at page 14.

³⁰ See March 3, 1993 Data Request question No. 4, and November 18, 1993 data request.

³¹ The offer to provide the complete 5 binder translation table from function code to Part 32 Account was made to audit team member Ms. Wiecki, on February 25, 1993 during a presentation in Wisconsin.